

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

PERIODIC REPORTING  
(PROPOSAL SEVEN)

Docket No. RM2018-10

PETITION OF THE UNITED STATES POSTAL SERVICE FOR THE  
INITIATION OF A PROCEEDING TO CONSIDER PROPOSED CHANGES  
IN ANALYTICAL PRINCIPLES (PROPOSAL SEVEN)  
(June 29, 2018)

Pursuant to 39 C.F.R. § 3050.11, the Postal Service requests that the Commission initiate a rulemaking proceeding to consider a proposal to change analytical principles relating to the Postal Service's periodic reports. The proposal, relating to a reorganization of Cost Segment 3 and certain mail processing cost pools to reflect operational changes and to better classify clerk and mail handler work activities, is labeled Proposal Seven and is discussed in detail in the attached text.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Nabeel R. Cheema  
Chief Counsel, Pricing & Product Support

Eric P. Koetting

475 L'Enfant Plaza, S.W.  
Washington, D.C. 20260-1137  
(202) 277-6333  
eric.p.koetting@usps.gov  
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## **Proposal Seven: Revisions to Cost Segment 3 Cost Pools**

### **Objective:**

The objective of this proposal is to reorganize Cost Segment 3 and certain mail processing cost pools to reflect operational changes and to better classify clerk and mail handler work activities.

### **Background:**

Since its inception for the FY1996 base year in Docket No. R97-1, the current Cost Segment 3 methodology has divided clerk and mail handler costs into costs incurred at “MODS” offices, NDCs, and “non-MODS” facilities. Originally, MODS offices had the most detailed available operating data via the namesake Management Operating Data System. While most MODS office costs were mail processing at plants, the MODS group also included some customer service facilities including post offices, stations, and branches. NDCs (then BMCs) have remained an operationally distinct group of mail processing facilities, focused on processing ground parcels and handling of bulk mail. The residual non-MODS facilities, primarily post offices and other customer service facilities not in the MODS group, did not have available operating data. Within each office group, the Cost Segment 3 model divides mail processing activities into activity-based cost pools. The cost pools serve as the units of analysis for which mail processing volume-variable costs by product are developed. The cost pools allow for distinct causal assignments of volume-variable costs to products for activities with distinct product mixes and/or distinct roles in the mail processing system.

The MODS system was refocused on plant operations in the early 2000s, and thus customer service facilities in the MODS office group largely ceased reporting data to the MODS system. However, the technical definition of the MODS office group retained the former MODS customer service facilities in the MODS office group to preserve a consistent definition of the group over time. Meanwhile, improvements to the non-MODS cost methodology introduced activity-based mail processing cost pools which currently offer finer activity detail than the corresponding MODS cost pools. In particular, the non-MODS cost pools distinguish costs for allied labor and for manual processing of letters, flats, and parcels, whereas the corresponding “MODS” costs are combined in the LDC 43 cost pool. For purposes outside of regulatory costing methodology, the Postal Service does not treat MODS and non-MODS customer service facilities as distinct groups. Rather, the primary operational distinction is between “Function 1” mail processing (i.e., mail processing at plants) and “Function 4” activities (processing, window service, and other activities at customer service facilities including post offices, stations, and branches). A significant aim of this proposal is to align the Cost Segment 3 office groups with this operational distinction, and to provide a common set of cost pools for reporting Function 4 costs based on the non-MODS cost pools.

Mail processing cost pools also require periodic revision to maintain consistency with Postal Service operations. Over the years, cost pools have been eliminated for equipment no longer in service, while other pools have been added to accommodate significant deployments of new equipment, such as the Flats Sequencing System (FSS). This proposal includes several mail processing cost pool changes intended to

improve the treatment of certain new equipment, as well as to prepare for the eventual withdrawal of other equipment from service.

Proposal:

The Postal Service proposes to reorganize the MODS and non-MODS office groups for the Cost Segment 3 model, and to revise several mail processing cost pools for MODS plants and NDCs:

1. Redefine the “MODS” office group to include only MODS-reporting plants, with other offices assigned to the non-MODS group<sup>1</sup>
2. Consolidate LDC 15 LCREM operations (currently in cost pool LD15PLNT) into the D/BCS cost pool
3. Consolidate the FSM/1000 cost pool into the AFSM100 cost pool
4. Consolidate the 1FLATPRP cost pool (MODS operation 035) into the AFSM100 cost pool
5. Collect operations for the Low-Cost Universal Sorter (LCUS) and Sack Sorting Machine in new LCUS-SSM cost pools for MODS offices and NDCs, supplanting the current MODS 1SACKS\_M cost pool as well as the NDC SSM cost pool

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<sup>1</sup> The MODS/non-MODS realignment would be implemented by altering the query that develops costs by office group and LDC to encompass costs for a specific list of MODS-reporting plants, instead of Reporting Office Group (ROG) 1 as in the current methodology. In addition, the proposal would transfer the small remaining amount of Function 4 costs (and associated IOCS tallies) from the MODS group to the non-MODS group, rather than retain small MODS Function 4 cost pools with distribution keys based on small effective IOCS samples. The development of cost pools by office group would otherwise continue to follow the calculations in the USPS-FY17-7 (and -NP18) Part 1 workbooks. The MBC.sas program would be modified to assign the corresponding IOCS tallies to the non-MODS group. The modified workbooks and SAS code are provided in USPS-RM2018-10/1 (and USPS-RM2018-10/NP1).

6. Eliminate the current plant MECPARC and NDC NMO cost pools
7. Reorganize the APBSPRIO and APBS OTH cost pools such that the former includes all applicable parcel (TPH) operations, limiting the latter to bundle (NATPH) operations
8. Move NDC LDC 14 manual Priority Mail distribution operations from the OTHR cost pool to the MANP cost pool<sup>2</sup>
9. Employ non-MODS methodology to assign all Function 4 costs to cost pools, including costs pools currently in the MODS office group<sup>3</sup>
10. Realign facility space categories and distribution keys in conjunction with labor cost changes.

Rationale:

1. Redefine the “MODS” office group to include only MODS-reporting plants, with other offices assigned to the non-MODS group

In the Cost Segment 3 model, the MODS office group is technically defined as the set of offices in Reporting Office Group (ROG) 1. As noted above, under the current definition, “MODS” offices include both plants that report data to the Management Operating Data System (MODS) and a large number of finance numbers representing customer service facilities (e.g., post offices, stations, and

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<sup>2</sup> The cost pool changes in items 2-8 are implemented by modifying the operation-to-cost pool maps for MODS plants and NDCs. The modified maps are provided in USPS-RM2018-10/1.

<sup>3</sup> The non-MODS methodology is implemented using the existing SAS code for non-MODS mail processing, administrative, and window service costs, applied to the expanded non-MODS office group.

branches) that do not report workhour or workload data to MODS. As a practical matter, non-plant MODS offices and non-MODS offices resemble each other much more closely than either group resembles MODS plants. The proposal will make it easier to analyze mail processing costs at post offices, stations, and branches under a common set of cost pools. The proposed new definition of the MODS group would be as a specific list of MODS-reporting plant finance numbers; other ROG 1 finance numbers would be assigned to the non-MODS office group.

MODS plants and customer service facilities in the MODS office group are highly distinct in the cost pool composition of their costs. Clerk and mail handler costs at MODS plants are primarily in LDCs 11-18, whereas customer service offices' costs are primarily in LDCs 41-49 and LDC 79, generally similar to non-MODS offices. Under the proposed method, the MODS office group would continue to include 99.9 percent of FY2017 costs in LDCs 11-18 ("Function 1" mail processing); this proposal would not, in itself, constitute a major change for those cost pools. The offices that are proposed to shift to the non-MODS group, in contrast, include nearly all of the mail processing costs which are in "Function 4" (LDC 41-49) cost pools. Under the proposal, shifting a small amount of remaining Function 4 MODS costs at plant finance numbers, which appear to be related to customer service facilities co-located with plants, will avoid having to use several small Function 4 MODS cost pools with relatively small samples of IOCS tallies to form the associated distribution keys. As discussed under item 9,

below, this change will provide for more consistent treatment of Function 4 costs than the accepted method. Currently, costs for otherwise similar activities—particularly manual mail processing at customer service facilities—may be treated differently depending on whether they occur at a MODS or non-MODS finance number.

2. Consolidate LD15PLNT cost pool with D/BCS

The LD15PLNT cost pool includes MODS operations for the Low-Cost Reject Encoding Machine (LCREM) that are assigned to Labor Distribution Code (LDC) 15. This is a small cost pool, with total pool costs of \$1.8 million in FY2017. The FY2017 IOCS sample has 23 tallies (including 12 direct tallies) for the LD15PLNT cost pool. Other LCREM operations already are included in LDC 11 and are currently part of the D/BCS cost pool, with pool total costs of \$1.528 billion in FY17.

3. Consolidate the FSM/1000 into the AFSM 100 cost pool

Consolidating the FSM/1000 cost pool with the AFSM 100 cost pool is intended to provide for the phase-out of remaining operations for UFSM 1000 equipment. The FSM/1000 cost pool's accrued mail processing costs have declined from over \$226 million in FY 2004 (see Docket No. R2005-1, USPS-LR-K-100, Table II-a) to \$2.46 million in FY 2017 (see Docket No. ACR2017, USPS-FY17-7 Part1.xlsx) as most of the UFSM 1000 flat sorters have been withdrawn from service. As of the beginning of FY 2017, the Postal Service still employed just 22 of the original 355 FSM 1000s, and the Postal Service expects continued decline in the use of the remaining UFSM 1000 equipment. The decline in costs has also

reduced the IOCS tally sample size for the FSM/1000 cost pool considerably; the FSM/1000 cost pool has 33 IOCS tallies (including 20 direct tallies) in FY2017.

The level of activity in the FSM/1000 cost pool is no longer at a level where retaining it as a separate cost pool has a material effect on mail processing costs.

4. Consolidate the 1FLATPRP cost pool into the AFSM100 cost pool

Consolidating the 1FLATPRP cost pool (MODS operation 035) with the AFSM 100 cost pool is intended to harmonize the treatment of 1FLATPRP (MODS operation 035) with other flat preparation operations in the Cost Segment 3.1 model. The AFSM100 cost pool currently includes MODS operation 140 (flat preparation activities for AFSM 100 Automated Induction equipment), and the FSS cost pool includes MODS operation 530 (Stand-Alone Mail Prep, the FSS prep operation). The separate treatment of 1FLATPRP historically allowed for the possibility that the operation 035 flat prep activities could be used to support multiple types of flat sorters in addition to the AFSM 100. However, the small and declining scale of the remaining FSM/1000 operations no longer justifies separate treatment of 1FLATPRP. Additionally, eliminating 1FLATPRP as a separate allied labor cost pool should minimize the extent to which mixed-mail costs in 1FLATPRP are distributed on IOCS direct tallies from operations other than AFSM100.



5. Collect operations for the Low-Cost Universal Sorter (LCUS) and Sack Sorting Machine in LCUS-SSM cost pools for the MODS and NDC facility groups, supplanting the current MODS 1SACKS\_M and NDC SSM cost pools

Since LCUS operations were introduced, the associated MODS operations (including operations for the HSUS and USS universal sorters) have been spread over several cost pools in the current methodology, depending on processing mode. For MODS facilities, they are assigned variously to the 1SACKS\_M, MECPARC, and APBSPRIO cost pools; for NDCs, they appear in the APBS, PSM, and SSM cost pools. The LCUS and related equipment types generally handle sacks and parcels that are too large to process on equipment designed to handle smaller packages, and thus would tend to have a distinct mail mix compared to other package sorting equipment. LCUS operations currently contribute the bulk of the workhours to the MODS 1SACKS\_M cost pool, and a smaller but substantial share of NDC SSM cost pool hours. The consolidation should limit the potential impact of clocking errors within LCUS operations. It will also facilitate the computation of operation-specific piggyback costs by allowing a direct mapping of non-labor costs for LCUS equipment (including costs for facility space, equipment, maintenance, and materials) to the corresponding labor cost pools.

6. Eliminate the MODS plant MECPARC and NDC NMO cost pools

When introduced for FY1996, the MECPARC cost pool was originally intended to represent activities at a small number of non-NDC Parcel Sorting Machines (PSMs). Currently, nearly all of the workhours in the MODS MECPARC cost pool

in FY 2016 were in LCUS/HSUS/USS operations, and the very small amount of non-LCUS workhours appear to be the result of minor clocking errors in TACS. Consequently, there are no other valid plant operations remaining in the MECPARC cost pool after the universal sorter operations have been gathered into the new LCUS-SSM cost pool. To the extent new automated parcel equipment were to be deployed to non-NDC plants in the future, the Postal Service would propose to assign those operations to the APBSPRIO cost pool.

MODS data for the NDC NMO operation (MODS operation 625) showed that the NMO operation largely ceased after quarter 1 of FY2017. No workload, and a very small number of hours, were reported in quarters 2-4 of FY2017. As with MECPARC, the remaining few hours are sufficiently small as to reflect minor TACS errors. Thus, there will be no valid workhours for the NDC NMO cost pool going forward.<sup>4</sup>

7. Reorganize APBSPRIO and APBS OTH cost pools

In the current methodology, automated parcel sorting operations at plants are primarily assigned to APBSPRIO, and bundle sorting operations are assigned to APBS OTH. However, the latter also includes several minor parcel operations with a small number of workhours. Moving these parcel operations to APBSPRIO will be consistent with the treatment of other parcel operations, and will reinforce the conceptual definition of APBS OTH as the automated bundle sorting cost pool.

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<sup>4</sup> For the purposes of the impact analysis, the FY2017 NDC NMO cost pool was combined with the NDC LCUS-SSM cost pool.

8. Move NDC LDC 14 Priority Mail operations from the OTHR cost pool to the MANP cost pool

The NDC OTHR cost pool collects a variety of distribution, allied labor, and miscellaneous operations not elsewhere classified in the mail processing cost model for NDCs. When the NDC manual parcel (MANP) cost pool was defined, NDCs did little or no processing of Priority Mail or other preferential parcels. In current NDC operations, however, NDC operations for Priority Mail parcel sorting comprise most LDC 14 workhours assigned to the NDC OTHR cost pool.

Collectively, those operations recorded 548,934 workhours in FY2017, nearly as many as the 567,212 workhours in the MANP cost pool under the accepted definition. Compared to the current methodology, treating these operations as part of the MANP distribution cost pool will reduce the possibility that mixed-mail costs will be distributed to non-parcels and/or to parcel products that receive automated processing.

9. Consolidate MODS Function 4 cost pools with the non-MODS group, using the non-MODS cost pool definitions

Combining the current MODS Function 4 and non-MODS cost pools will simplify reporting of Function 4 costs—currently spread across cost pools in the two office groups that are defined similarly, but not identically—and reduce cases in which costs from otherwise similar activities may be treated differently based on the office group into which they happen to fall. The use of the IOCS-based non-MODS cost pool definitions aligns with the Commission's accepted methodology for partitioning Cost Segment 3 into the mail processing (3.1), window service

(3.2), and administrative (3.3) components, and considerably reduces the amount of costs subject to the migrated cost adjustment in the B Workpapers for Cost Segment 3.<sup>5</sup> The non-MODS cost pool definitions also provide more detail on mail processing activities, particularly allied labor and shape-based manual distribution, than the MODS cost pool definitions, in which the LDC 43 cost pool combines those activities. While the use of the non-MODS cost pool definitions would eliminate the use of census-based LDC-level costs for MODS offices, the larger effective sample sizes from combining MODS Function 4 tallies with non-MODS should result in little or no adverse effect on the coefficients of variation (CVs) for the sample-based cost estimates.

10. Realign mail processing facility space categories and distribution keys to comport with related labor cost changes.

Facility costs piggybacked on mail processing cost pools are distributed using mail processing labor distribution keys. Under the proposed methodology, labor cost pool consolidations would require corresponding consolidations of associated facility space distribution keys and associated space costs (and square footage). In many cases, space categories that require consolidation map directly into the combined categories under the proposal. In other cases, notably space assigned to the MODS LDC 43 distribution key, a crosswalk to the proposed non-MODS cost pool assignments was derived from the facility survey data. Versions showing required revisions of the facility cost workbook from

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<sup>5</sup> See Docket No. ACR2017, USPS-FY17-32, CS03-Public-FY17xlsx, worksheet “PRC 3.0.1a.” Additionally, the current migrated cost adjustment only moves costs associated with not-handling tallies, and only addresses migration from mail processing to window service and administration, not migration from the other Cost Segment 3 components to mail processing.

Docket No. ACR2017, USPS-FY17-8, and the corresponding space distribution keys, are provided in folder USPS-RM2018-10/1; a nonpublic version of the space distribution keys showing competitive product detail is provided in folder USPS-RM2018-10/NP1.

Impact:

The impact on product costs is shown in Table 1 provided in the Excel file directly attached to this document electronically. The Cost Segment 3 impact includes the effects of the proposal on the Mail Processing, Window Service, and Administrative components. Because this proposal includes changes to all of Cost Segment 3 and to space distribution keys, the overall impact is based on a CRA run that includes the impact of the revisions to distribution keys for piggybacked costs. In some cases, the effects of these changes on piggybacked costs may variously reinforce or offset the direct impact on Cost Segment 3 labor costs. In most cases, the impacts on product costs are small.<sup>6</sup> A non-public version of Table 1 showing competitive product detail is provided under seal in folder USPS-RM2018-10/NP1.

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<sup>6</sup> The largest impact, on Other Ancillary Services, occurs as a result of costs from the MODS LDC 42 (LD42) cost pool shifting primarily to the non-MODS Business Return Services (BUSREPLY) cost pool. Costs associated with certain tallies for Business Reply and other return services are assigned to the mail product in the LD42 pool, but to the reply service in the BUSREPLY pool. The LD42 cost pool's treatment of such tallies had not been updated when LDC 42 was redefined from mechanized distribution activities at post offices, stations, and branches to Function 4 work related to return services. The Postal Service notes that the non-MODS BUSREPLY method is consistent with that of the corresponding Function 1 (LDC 18) MODS BUSRREPLY cost pool.